PHILIPPINES ECONOMIC WRAP-UP

JULY 21 - 27, 2001

Summary

The peso weakened, stock prices languished further, and domestic interest rates rose despite efforts to bolster the local currency. Towards the end of the week, the Central Bank announced higher reserve requirements and stricter rules for over-the-counter foreign exchange transactions to discourage speculative pressure on the Philippine currency. President Macapagal-Arroyo's first State of the Nation Address (SONA, delivered on July 23) did little to boost financial markets during the week despite its emphasis on the private sector and endorsement from the business community. Budget officials provided a "preview" of the 2002 executive branch's P780 billion budget proposal in reaction to opposition criticisms that the SONA "promises" were too financially ambitious to be realistic. We also report that the national government raised $224 million from its first ever currency swap deal for budget financing purposes. End summary.

These weekly reviews are available on the Embassy's web site (http://usembassy.state.gov/manila). We provide a longer and more detailed review of the Philippine economy in our June 2001 Economic Outlook, which is also available on our web site.

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FOREX REPORT

The late-week respite for the Philippine currency during the July 16-20 trading period was short-lived. Downward pressure resumed as a new week opened and the peso closed at P53.45/US$ on July 27 (down 0.6% from July 20's P53.15/US$ level) despite late-week gains on rumored "intervention" by the Bangko Sentral ng Pilipinas (BSP, the central bank) and BSP measures to mop up liquidity and tighten foreign exchange regulations.

Exchange Rate Tables

Date	Weighted Average (Pesos/US$)	Closing (Pesos/US$)	Volume (Million US$)
JUN 18	51.819	51.975	141.5
19	52.282	52.320	109.5
20	52.071	52.010	233.8
21	52.101	52.200	122.5
22	52.281	52.210	74.5
JUN 25	52.252	52.265	54.9
26	52.307	52.270	91.5
27	52.308	52.295	55.3
28	52.366	52.370	101.5
29	52.428	52.395	96.0
JUL 02	52.612	52.700	93.0
03	52.905	52.940	113.5
04	53.025	52.930	145.5
05	52.965	52.980	111.1
06	52.901	52.890	73.5
JUL 09	52.863	52.835	71.6
10	52.910	52.950	68.0
11	53.023	53.065	76.7
12	53.246	53.080	119.0
13	53.186	53.170	46.0
JUL 16	53.503	53.710	50.4

17	53.896	53.950	49.5
18	53.928	53.700	168.5
19	53.316	53.200	122.3
20	53.210	53.150	154.8
JUL 23	53.387	53.400	110.6
24	53.552	53.550	36.2
25	53.587	53.600	96.7
26	53.538	53.420	101.6
27	53.389	53.450	76.0

Source: Bankers Association of the Philippines

CREDIT MARKET REPORT

Banks and securities dealers upped bid rates further for longer-term Treasury bills during the Bureau of Treasury's weekly T-bill auction on July 23. The Treasury made a full award of the P1.5 billion each of the 182-day and 364-day instruments on offer at average rates of 10.861% (up 37.2 basis points) and 11.988% (up 22 basis points), respectively. Meanwhile, for the first time in four weeks, the average rate for the 91-day bills softened somewhat to 8.935% (down by 2.3 basis points week-on-week). The Treasury received nearly P2 billion in tenders for the 91-day paper –- double the volume scheduled for sale.

Analysts commented that the T-bill auction results indicated investors' bias for shorter-term instruments and the premium demanded for longer-term investments reflected economic, foreign exchange rate, and fiscal uncertainties. The Treasury's full award of the longer-term T-bills at a higher premium may also reflect part of the "synchronized" policies which the Department of Finance (DOF) and Bangko Sentral ng Pilipinas said they would take to temper emerging speculative pressures on the local currency.

Domestic Interest Rates (in percent)

Treasury Bills

Auction Date	91 days	182 days	364 days
JUN 04	8.913	9.839	10.792
JUN 11	8.729	9.700	10.823
JUN 18	8.653	9.780	10.965
JUN 25	8.728	no sales	11.092
JUL 02	8.770	9.942	11.221
JUL 09	8.849	10.172	11.419
JUL 16	8.958	10.489	11.768
JUL 23	8.935	10.861	11.988

Source: Bureau of the Treasury

Prime Lending Rates of 14 Expanded Commercial Banks

Date of Survey	Average	Range
JUN 14	12.8122	10.00 – 14.000
JUN 21	12.7828	10.00 – 14.000
JUN 28	12.6328	10.00 – 13.728
JUL 05	12.5638	10.00 – 13.770
JUL 12	12.5837	10.00 – 13.849
JUL 19	12.6249	10.00 – 13.958

Sources: Bangko Sentral ng Pilipinas; Press reports

STOCK MARKET REPORT

Reflecting discouraging industrial production figures and other negative domestic news, as well as continued downward pressure on the Philippine currency, the Philippine Stock Price Index (Phisix) continued to falter. Stock market analysts also blamed news of weak U.S. corporate earnings for exacerbating uncertainties over Philippine economic growth prospects. The Phisix closed the first four days of the week successively weaker to sink to its lowest closing level in nearly nine months on July 26. End-of-week bargain hunting gave the Phisix a slight upward nudge to close at 1363.34 on July 27, down 0.9% from July 20. (See Section II for detailed stock market data.)

Philippine Stock Exchange Index (PHISIX) and
Value of Shares Traded

Date	PHISIX Close	Value (Million pesos)
JUN 18	1470.92	393
19	1448.73	474
20	1449.45	415
21	1444.17	547
22	1439.77	1,093
JUN 25	1424.52	1,093
26	1423.44	521
27	1415.73	479
28	1414.79	436
29	1410.07	2,972 c/
JUL 02	1395.79	543
03	1392.07	464
04	1385.99	525
05	1402.23	464
06	1396.92	278
JUL 09	1405.39	346
10	1397.66	447
11	1390.10	284
12	1399.42	289
13	1396.30	208
JUL 16	1397.61	377
17	1384.01	798
18	1382.28	325
19	1381.87	625
20	1376.36	330
JUL 23	1374.83	516
24	1369.02	441
25	1366.01	472
26	1362.58	368
27	1363.34	584

a/ includes P6.57 billion block sale of Pure Foods to San Miguel Corporation

b/ about P2 billion accounted for by trading of blue-chip Philippine Long Distance Telephone Co. (PLDT) shares (reportedly on news of a debt restructuring plan forged with creditors by PLDT's struggling subsidiary Piltel)
c/ includes P2.4 billion cross transaction in relation to Globe-Islacom merger

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Source: Philippine Stock Exchange

BSP MOVES TO TIGHTEN LIQUIDITY, EASE FOREX PRESSURE

BSP Governor Rafael "Paeng" Buenaventura announced on July 26 that the Philippine Monetary Board (BSP's highest policy making body) decided to raise reserve requirements imposed on deposits, common trust funds, and other trust and fiduciary liabilities of commercial banks and non-banks with quasi-banking functions (NBQBs) by two percentage points effective July 27. The increase applied to "liquidity" reserves (i.e., reserve requirements earning market-based yields), rather than to "statutory" reserves, to minimize upward pressure on lending rates.

Liquidity reserves of commercial banks and NBQBs now stand at 9% (from 7%), with statutory reserves maintained at 9%. Explaining the Monetary Board's decision, the BSP Governor noted that domestic liquidity growth accelerated in May but that lethargic loan growth and the economy's slowed expansion appeared to be driving peso liquidity into investments in foreign assets. By increasing liquidity reserve requirements, the Monetary Board hoped to moderate future liquidity growth, mitigate inflationary expectations, and ease pressure on the local currency.

To counter currency speculation, Governor Buenaventura also announced that the Monetary Board had lowered the allowable level of over-the-counter foreign exchange sales by banks and foreign exchange corporations to clients without documentation requirements from $10,000 to $5,000. The BSP Governor emphasized that the reduction was not a form of foreign exchange control, noting that foreign exchange could be purchased without limitation above the $5,000 threshold by legitimate users with proper supporting documents. He added that the lower ceiling was intended to discourage abuse through the splitting of foreign exchange sales by banks and foreign exchange corporations. BSP bank supervision officials cited splitting of foreign exchange transactions as the most prevalent, suspected violation of forex regulations based on their scrutiny of banks' transaction reports (i.e., bank regulators noted several foreign exchange purchases made under different names but indicating common addresses).

During the week, the Bangko Sentral also issued a "stern warning" to banks (including their subsidiaries and affiliates) to strictly enforce foreign exchange rules and regulations and to remind them of the monetary and non-monetary sanctions at the BSP's disposal. The BSP noted a recent rise in foreign exchange transactions which seemed to be aggressively testing (if not breaching) prudential regulations and limits. In its warning, the BSP also enumerated some of the more serious infractions, which included: disregard of prior BSP approval where required; the absence of supporting documents for consummated foreign exchange deals; foreign exchange sales for the remittance of non-registered investments; foreign exchange sales directly for credit to foreign currency deposit unit accounts; and other speculative activities (including "churning").

GOP ENTERS INTO FIRST EVER CURRENCY SWAP DEAL
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On July 25, the Dept. of Finance (DOF) announced that the national government had entered into a currency swap deal with Hong Kong Shanghai Banking Corp. (HSBC). According to DOF officials, this marked the first time that the Philippines has used a derivative for budget funding purposes. Under the swap arrangement, the government converted P11.8 billion worth of 3- and 5-year fixed rate treasury notes (raised from a July 24 auction) to $220.4 million of floating rate US$-denominated liabilities.

The DOF said that the after-swap cost of the deal equated to 6-month LIBOR plus 1.7% and 1.9%, respectively, for the 3- and 5-year maturities. According to Treasury chief Sergio Edeza, the government expects the currency swap to generate savings of between $18-19 million (about P1 billion) in interest costs over the life of the transaction. He noted that a floating rate issue in the US$ bond market would have required spreads of 3.25% and 4.25% for the 3- and 5-year maturities, respectively, given current jitters over emerging market debt.

PRES. GMA’S FIRST STATE OF THE NATION ADDRESS

On July 23 (Monday), President Gloria Macapagal-Arroyo (GMA) delivered her first State of the Nation Address (SONA) before the newly-elected Twelfth Philippine Congress. The President’s speech outlined four components of the administration’s anti-poverty agenda –- free enterprise, a modernized agricultural sector founded on social equity, a social bias towards the disadvantaged, and raising the moral standards of government and society (i.e., peace and order, as well as public and private sector governance).

Responding to criticisms that the administration lacked clear direction, President Macapagal-Arroyo articulated a number of specific goals and objectives. These included: P20 billion in annual funding to implement the 1997 Agricultural Fisheries and Modernization Act (AFMA); 200,000 hectares annually for distribution to land reform beneficiaries; 150,000 low-cost/socialized housing units yearly; the staggered completion by 2006 of five new mass transit lines; a plan to build a school building in every “barangay” (the smallest political subdivision) by 2004; 85% electrification of all “barangays” within a year (equivalent to the electrification of 4 “barangays” daily); and an annual emergency employment program for 20,000 out-of-school and out-of-work youth in Metro Manila.

The SONA was generally well-received by the business community, particularly its emphasis on private sector participation, but did little to boost foreign exchange, equities, and credit markets. Meanwhile, several opposition officials slammed the SONA as financially ambitious and unrealistic, considering the weak state of government finances.

CABINET TO PROPOSE P780 BILLION BUDGET FOR 2002

On July 24 (Tuesday), to address concerns raised about the SONA, the Dept. of Budget and Management (DBM) announced that the Philippine Cabinet had agreed on a P780 billion budget (obligation basis) for the 2002 fiscal year. DBM officials told the Embassy that the executive branch expects to submit the detailed budget proposal to the Philippine Congress on or before August 9.

DBM Secretary Emilia Boncodin emphasized that the proposed 2002 budget was consistent with the development goals articulated in President Macapagal-Arroyo's SONA. She stressed that the government had "triple-checked that these projects are doable because they have funds if not in the 2001 budget, then in the 2002 proposed budget." She further clarified that not all projects stated in the SONA would be financed from the national government budget. Funds for housing, for example, already fall under the purview of government social security and housing finance institutions, while major infrastructure projects (such as the additional rail transit lines) can be implemented through private sector participation under the government's build-operate-transfer (BOT) program.

DBM Secretary Boncodin candidly admitted that all of the 11.6% year-on-year increase in the executive branch's 2002 budget proposal will be eaten up by "non-discretionary" budget items –- i.e., interest payments, personnel salaries/benefits, and legally mandated transfers to local government units. Therefore, she stated that DBM adopted a "priority test" to focus resources on programs and projects deemed critical to the administration's anti-poverty campaign. A budget official told the Embassy that over P230 billion -- equivalent to almost a fourth of total budget requests received from government agencies -- were excluded in the course of the prioritization exercise. Providing a "preview" of the budget proposal, the Budget Secretary cited a number of specific programs targeted to receive substantial funding next year according to the thrusts stated in the President's SONA: P18.6 billion for AFMA (plus credit facilities to farmer borrowers from the Land

Bank of the Philippines, a government-owned bank which specializes in agricultural lending); P10.6 billion for the Comprehensive Agrarian Reform Program (CARP); P49.7 billion for the government's infrastructure program; and P10 billion for the modernization program of the Armed Forces of the Philippines.

The national government is targeting gradually declining deficits towards a balanced budget by 2006. For 2002, the national government hopes to narrow its fiscal deficit to P130 billion (a 10% decline from the P145 billion ceiling programmed for 2001). Budget officials told the Embassy that the national government's 2002 revenue target was based on more realistic assumptions, among them a downward-revised GDP growth target (4.3% from 4.8% previously). The 2002 revenue goal also takes off from downward-revised revenue expectations for 2001, reflecting a lower GDP growth expectation (3.3% from 3.8%) and taking into account persistent shortfalls in Bureau of Internal Revenue (BIR) collections (whose 2001 collection target was cut by P20 billion).

Embassy computations indicate that roughly 70% (P50 billion) of the targeted P72.4 billion (14.5%) year-on-year increase in the 2002 tax collection goal hinges on achieving economic growth targets; and the balance on improving the tax-to-GDP ratio (a measure of tax collection efficiency) from 13.8% in 2001 to 14.4% in 2002. While President Macapagal-Arroyo's fiscal team has been lauded for its strong resolve to live within its means, improved tax administration and revenue mobilization remains crucial to sustaining a responsible deficit reduction plan.

NATIONAL GOVERNMENT'S 2002 FISCAL PROGRAM
(Amounts in Billion Pesos)

	2001 Original	2001 Revised	2002	% Change 2002/2001
REVENUES	568.2	558.2	624.3	11.8
Tax	519.6	498.9	571.3	14.5
BIR	408.1	388.1	447.6	15.3
Customs	105.1	105.1	115.1	9.5

Others	6.4	5.7	8.6	50.9
Non-Tax	48.6	59.3	53.1	(10.5)
DISBURSEMENTS a/	713.2	703.2 b/	754.3	7.3
SURPLUS/(DEFICIT)	(145.0)	(145.0)	(130.0)	10.3

Selected Revenue Assumptions

Nominal GDP Growth	10.0%	8.4%	11.8%
Real GDP Growth	3.8%	3.3%	4.3%
Inflation Rate	6-7%	6-7%	5-6%
Revenue/GDP Ratio	15.5%	15.4%	15.8%
Tax/GDP Ratio	14.2	13.8%	14.4%

a/ cash basis

b/ reduced to reflect the level of “underspending” posted during the first half of the year (which the government hopes to maintain through the remainder of 2001)

Sources: Dept. of Budget and Management; Dept. of Finance